

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

| | | |
|------------------------------|---|-----------------|
| ROBERT E. STEPHENS, |) | |
| |) | |
| COMPLAINANT |) | |
| |) | |
| v. |) | CASE NO. 97-145 |
| |) | |
| HIGHLAND COMMUNICATIONS OF |) | |
| TENNESSEE AND HIGHLAND |) | |
| TELEPHONE COOPERATIVE, INC., |) | |
| |) | |
| DEFENDANTS |) | |

O R D E R

On March 12, 1997, Robert E. Stephens ("Complainant") filed a formal complaint ("Complaint") alleging that the people of the Commonwealth of Kentucky were misinformed by a tariff filed on February 14, 1997, by Highland Communications of Tennessee ("Highland Communications").¹ The tariff was included in a filing notifying the Commission of Highland Communications' intent to provide long distance services in Kentucky. The Complaint alleges that the incorporation of Highland Communications by Highland Telephone Cooperative, Inc. ("Highland Telephone") was a "ploy" to transfer assets of Highland Telephone to Highland Communications.² Further, Complainant states that Highland Telephone's rates are "exorbitant"³ and that funds used to establish Highland

¹ Complaint at 1.

² Id. at 6.

³ Id.

Communications should be returned to members by means of capital credit payments or reductions in telephone rates.⁴

On April 14, 1997, Highland Communications filed its response. On June 11, 1997, the Commission made Highland Telephone a party to the proceeding, citing Complainant's claims that Highland Telephone had violated its cooperative objectives by using its surplus to establish Highland Communications, a "for profit" company, and that Highland Telephone's excessive rates had created the surplus. On June 25, 1997, Highland Telephone responded to these issues, which were cited in the Commission's Order. Highland Telephone argues, among other things, that establishing Highland Communications better enables it to respond to competitive pressures and to continue its commitment to expand and improve its service to its membership in Kentucky and Tennessee. Highland Telephone disputes the claim that its rates are unnecessarily high, pointing out that it has not sought rate relief since November 1984.

Complainant's response dated July 7, 1997, states that Highland Telephone violated its corporate objectives by using cooperative funds to establish its affiliate. The remainder

⁴ The Complaint includes numerous additional allegations. However, the allegations largely reflect misunderstandings of tariff language or applicable law. For example, Complainant appears to aver that Highland Communications misrepresented the truth in advising the Commission that it would provide service to presubscribed customers because, when the tariff was filed, "there were no 'presubscribed customers'." Complaint at 1. However, pursuant to KRS 278.160, Highland Communications would have violated the law if it had sold services prior to approval of its tariff. Complainant also asks that the tariff's optional calling plans should be deleted. Complaint at 5. However, such plans violate no law and are commonplace in the competitive long distance market. Such problems as existed with the tariff have been corrected by Highland Communications subsequent to Commission staff review.

of the July 7 response alleges a lack of communication between Highland Telephone and its membership.

On July 30, 1997, the Commission issued an information request consisting of 22 questions. Highland Telephone responded to the questions on August 28, 1997. The gist of its argument is that the formation and funding of Highland Communications was a legal action within the authority of its board of directors. It further asserts that the creation of Highland Communications was merely a change in form, not substance, of the beneficial interest of Highland Telephone in the transferred property and that the transfer of interest helps protect and preserve Highland Telephone's tax-exempt status.

In its response to an information request dated November 3, 1997, Highland Telephone notes that KRS 279.360(10) expressly permits a rural telephone cooperative corporation to "become a member of other cooperatives or corporations or to own stock therein." In addition, KRS 279.360(13) and (15) empower rural telephone cooperatives to form contracts and perform other acts necessary to accomplish these purposes.

On December 1, 1997, the Complainant filed an additional response, reiterating his claims.

Although the documents filed by Complainant are lengthy and detailed, Complainant's allegations concern three major issues: first, that Highland Telephone lacked authority to establish an affiliated long distance company using cooperative funds; second, that surplus revenues provided by cooperative members are not available for capital credit rotations; and third, that Highland Telephone rates are excessive. Detailed and complete responses to these allegations have been filed by Highland Telephone. The record in this

case indicates that there is no dispute as to any material fact and that, based on applicable law, none of Complainant's claims has merit.

There is nothing novel in Highland Telephone's establishment of an affiliated company. Over the past years several telephone cooperatives have formed separate subsidiaries to hold their interests in cellular ventures and have entered into partnerships for the same purpose. These ventures have been financed by equity monies held by the cooperative. Cooperatives also have formed partnerships to provide resold long distance, again financing with equity monies.

When a company enters into these arrangements, it does so under the equity method of accounting. Under this method, all income of the affiliate or partnership flows back to the company in the form of dividends or profit distribution, thereby adding to the company's income and eventually enhancing capital credit rotation. Complainant cites no provision of law that would require the governing board of a telephone cooperative to handle its assets differently than the way in which those of Highland Telephone have been handled here. Indeed, a rural telephone cooperative is expressly empowered by KRS 279.360(10) to invest its assets in other corporations. As a matter of law, Complainant's objection to Highland Telephone's creation of a subsidiary must be dismissed.

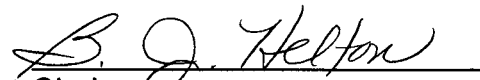
Finally, Complainant's allegations of exorbitant rates are unsupported by any evidence. Highland Telephone has not sought an increase in its rates since November 1984, and its rates for basic local exchange service do not appear to be unreasonable. Nor does the allegation that Highland Telephone possesses funds above its immediate operating needs indicate that it has violated any law, rule of ethics, or principle of


reasonable business practice. There is no requirement that a rural telephone cooperative must distribute to its members all monies it does not need for immediate operating purposes rather than pursuing prudent investment to ensure its continuing financial viability. Complainant's fear that stockholders of Highland Communications will "reap all the profits and possibly absorb [the members'] capital"⁵ is unfounded, because Highland Communications is a wholly owned subsidiary of Highland Telephone.

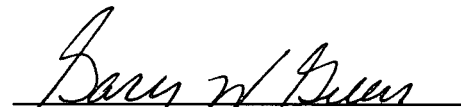
The Commission, having reviewed the record and having been otherwise sufficiently advised, HEREBY ORDERS that this case be, and it hereby is, dismissed.

Done at Frankfort, Kentucky, this 13th day of April, 1998.

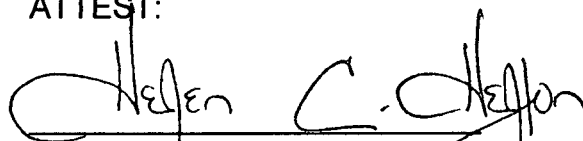
PUBLIC SERVICE COMMISSION


Chairman


Vice Chairman


Commissioner

ATTEST:


Executive Director